FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

PENSIONS AND INVESTMENTS COMMITTEE

WEDNESDAY, 8 JUNE 2022

Report of the Interim Director of Finance and ICT

Investment Report

1. Purpose

1.1 To review the Fund's asset allocation, investment activity since the last meeting, long term performance analysis and to seek approval for the investment strategy in the light of recommendations from the Interim Director of Finance & ICT and the Fund's independent external adviser.

2. Information and Analysis

2.1 Report of the External Adviser

A copy of Mr Fletcher's report, incorporating his view on the global economic position, factual information for global market returns, the performance of the Fund and his recommendations on investment strategy and asset allocation, is attached as Appendix 2.

2.2 Asset Allocation and Recommendations Table

The Fund's latest asset allocation as at 30 April 2022 and the recommendations of the Interim Director of Finance & ICT and Mr Fletcher, in relation to the Fund's final strategic asset allocation benchmark (SAAB), which came into effect on 1 January 2022, are set out on page 3.

The table also shows the recommendations of the Interim Director of Finance & ICT, adjusted to reflect the impact of future investment commitments. These commitments (existing plus any new commitments recommended in this report) relate to Private Equity, Multi-Asset Credit, Property and Infrastructure and currently total around £300m. Whilst the timing of drawdowns will be lumpy and difficult to predict, the In-house Investment Management Team (IIMT) believes that these are likely to occur over the next 18 to 36 months.

	Benchmark		Fund Allocation	Fund Allocation	Permitted Range	Benchmark Relative Recommendation		Recommendation (1)		Adjusted for Commitments (3)	Benchmark Sterling Return	Benchmark Sterling Return
	Intermediate (1)	Final (1)	31/1/22 (2)	31/4/22	Final (1)	AF 8/6/22	DPF 8/6/22	AF 8/6/22	DPF 8/6/22	DPF 8/6/22	3 Months to 31/3/22	3 Months to 30/4/22
Growth Assets	**56.0%**	**55.0%**	**55.9%**	**55.3%**	**+/- 8%**	**-**	**-**	**55.0%**	**55.0%**	**56.0%**	**n/a**	**n/a**
UK Equities	14.0%	12.0%	13.2%	13.5%	+/- 4%	-	+1.5%	12.0%	13.5%	13.5%	0.5%	1.1%
Overseas Equities:	38.0%	39.0%	38.0%	37.0%	+/- 8%	-	(2.3%)	39.0%	36.7%	36.7%	n/a	n/a
North America	6.0%	-	1.6%	1.6%	-	-	-	-	-	-	(2.0%)	(2.1%)
Europe	4.0%	-	0.5%	0.5%	-	-	-	-	-	-	(7.2%)	(6.2%)
Japan	5.0%	5.0%	5.3%	5.1%	+/- 2%	-	+0.5%	5.0%	5.5%	5.5%	(3.5%)	(3.8%)
Pacific ex-Japan	2.0%	-	0.9%	0.9%	-	-	-	-	-	-	(2.2%)	0.3%
Emerging Markets	5.0%	5.0%	5.1%	4.7%	+/- 2%	-	+0.6%	5.0%	5.6%	5.6%	(2.5%)	(3.6%)
Global Sustainable	16.0%	29.0%	24.6%	24.2%	+/- 8%	-	(3.4%)	29.0%	25.6%	25.6%	(2.7%)	(1.9%)
Private Equity	4.0%	4.0%	4.7%	4.8%	+/- 2%	-	+0.8%	4.0%	4.8%	5.8%	(2.5%)	(1.7%)
Income Assets	**24.0%**	**25.0%**	**22.2%**	**24.2%**	**+/- 6%**	**+2.0%**	**(0.8%)**	**27.0%**	**24.2%**	**28.2%**	**n/a**	**n/a**
Multi-Asset Credit	6.0%	6.0%	7.0%	6.9%	+/- 2%	+2.0%	+0.2%	8.0%	6.2%	8.4%	(0.2%)	0.1%
Infrastructure	9.0%	10.0%	7.5%	9.3%	+/- 3%	-	(0.6%)	10.0%	9.4%	11.2%	0.6%	0.6%
Direct Property (5)	5.0%	6.0%	4.6%	5.1%	+/- 2%	-	(0.3%)	6.0%	5.7%	5.7%	4.0%	4.0% (4)
Indirect Property (5)	4.0%	3.0%	3.1%	2.9%	+/- 2%	-	(0.1%)	3.0%	2.9%	2.9%	3.7%	3.7% (4)
Protection Assets	**18.0%**	**18.0%**	**16.8%**	**16.0%**	**+/- 5%**	**(2.0%)**	**(1.5%)**	**16.0%**	**16.5%**	**16.5%**	**n/a**	**n/a**
Conventional Bonds	6.0%	6.0%	4.8%	4.5%	+/- 2%	(1.0%)	(1.0%)	5.0%	5.0%	5.0%	(7.2%)	(6.2%)
Index-Linked Bonds	6.0%	6.0%	5.5%	5.5%	+/- 2%	-	(0.5%)	6.0%	5.5%	5.5%	(5.5%)	(9.1%)
Corporate Bonds	6.0%	6.0%	6.5%	6.0%	+/- 2%	(1.0%)	-	5.0%	6.0%	6.0%	(6.7%)	(7.6%)
Cash	**2.0%**	**2.0%**	**5.1%**	**4.5%**	**0 – 8%**	**-**	**+2.3%**	**2.0%**	**4.3%**	**(0.7%)**	**0.1%**	**0.1%**

Investment Assets totaled £6,030m at 30 April 2022.

(1) Intermediate benchmark effective from 1 January 2021 to 31 December 2021. Final benchmark effective from 1 January 2022. Recommendations are relative to the Final benchmark
(2) Adjusted for completed trades in early Feb-22 – North American Equities -1.0%; European Equities -0.7%; Global Sustainable Equities +1.1%; and Cash +0.5%.
(3) Adjusted for investment commitments at 30 April 2022, together with commitments placed post period-end. Presumes all commitments funded from cash.
(4) Benchmark Return for the three months to 31 March 2022.
(5) The maximum permitted range in respect of Property is +/- 3%.

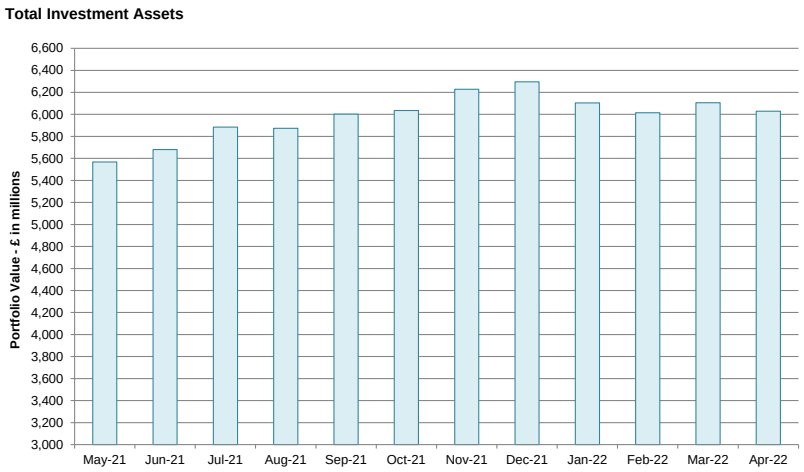
The table above shows the intermediate benchmark, together with the new final benchmark approved by Committee in November 2020. The final benchmark came into effect on 1 January 2022. The table above reflects the following three categorisations:

- **Growth Assets**: largely equities plus other volatile higher return assets such as private equity;
- **Income Assets**: assets which are designed to deliver an excess return, but with more stable return patterns than Growth Assets because income represents a large proportion of the total return of these assets; and
- **Protection Assets**: lower risk government or investment grade bonds.

Relative to the final benchmark, the Fund as at 30 April 2022, was overweight Cash and Growth Assets and underweight in Protection Assets and Income Assets. However, should all the IIMT recommendations set out in this report be implemented, together with the expected level of commitment draw-downs, the cash balance would reduce by 5.0% to -0.7%. In practice as these commitments are drawn-down, they will be partly offset by new net cash inflows from investment income, distributions from existing investments and changes in the wider asset allocation.

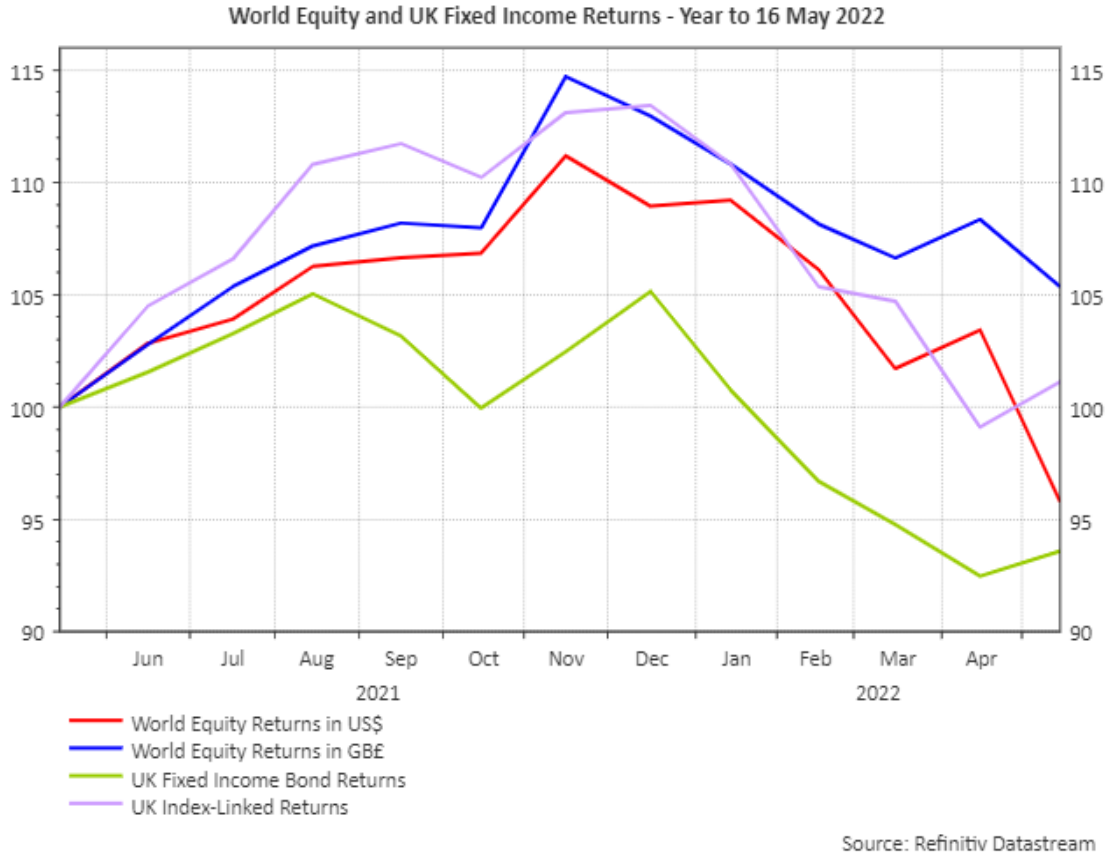
2.3 Total Investment Assets

The value of the Fund's investment assets reduced by £75m (-1.2%) between 31 January 2022 and 30 April 2022 to £6.030bn, comprising a non-cash market loss of around £90m, partly offset by cash inflows from dealing with members and investment income of around £15m. Over the twelve months to 30 April 2022, the value of the Fund's investment assets has increased by £461m (+8.3%), comprising a non-cash market gain of around £400m, and cash inflows from dealing with members & investment income of around £60m.



The Fund's valuation can fluctuate significantly in the short term, reflecting market conditions, and supports the Fund's strategy of focusing on the long term. A copy of the Fund's valuation as at 30 April 2022 is attached at Appendix 3.

2.4 Market returns over the last 12 months



The chart above shows market returns for Global Equities in Sterling and the US dollar, UK Fixed Income and UK Index Linked bonds for the twelve months to 16 May 2022. Although equity returns are positive in sterling terms over the 12-month period, they have declined since the beginning of the year. In US dollar terms the year-to-date decline has been even more pronounced, meaning that global equity markets lost approximately 4% over the 12-month period.

The FTSE All World peaked at an all-time high in early January 2022. However, equities soon came under pressure from shifting central bank policy. Throughout 2021, the major central banks had been actively maintaining very accommodative monetary policies to support economies through the Covid-19 pandemic. During the final quarter of 2021, there was a distinctive shift in messaging from the Bank of England (BoE) and the US Federal Reserve (US FED) as inflation proved to be more persistent than

initially anticipated and action was required to dampen economic activity. In November, the UK Consumer Price Index (CPI), a widely tracked measure of inflation, had already risen to 5.1% year on year, its highest level since 2011. The BoE enacted its first rate-increase in mid-December 2021, and in its end of year meeting the US FED conceded that interest rates may need to be increased “sooner or at a faster pace” to tackle inflation, with three interest rate-increases expected in 2022. As Central Banks were now entering an interest rate increase cycle and inflation readings were continuing to rise, government bond yields rose (meaning that their prices fell).

Global equity markets weakened as a result, with the FTSE All World falling by 4.9% during January (US$ terms), the largest intra-month fall since March 2020 (at the onset of the Covid-19 pandemic). Growth stocks, which have valuations that are highly sensitive to rising interest rates, sold off sharply, falling by over 9.0% in January 2022 alone. In contrast, Value stocks, which trade at lower prices relative to company fundamentals, fell by only 1.2%.

During January 2022, the US CPI reading reached 7.0% for the first time since 1982. In its month end meeting, the Federal Reserve became even more hawkish (more likely to tighten monetary policy), refusing to rule out a more aggressive pace of interest rate rises than had been indicated in the December meeting. At the beginning of February 2022, the BoE approved its first back-to-back interest rate rise since 2004, with the Bank warning that inflation would rise to 7.25% in April, a level that was last reached in 1991. Bond yields continued to rise, widening the divergence in performance between Growth and Value stocks.

In late February 2022, after months of posturing, Russia invaded Ukraine, upending the geopolitical landscape and creating a humanitarian crisis in eastern Europe. The invasion drew widespread condemnation and globally coordinated financial sanctions were targeted at the Russian economy, Vladimir Putin and his political connections. Russia’s central bank assets were frozen, preventing it from accessing over $600 billion of foreign currency reserves. Major Russian Banks were removed from the SWIFT international payments system and the Russian economy became increasingly isolated from international trade. Many Western countries also announced plans to transition away from Russian oil and gas supplies.

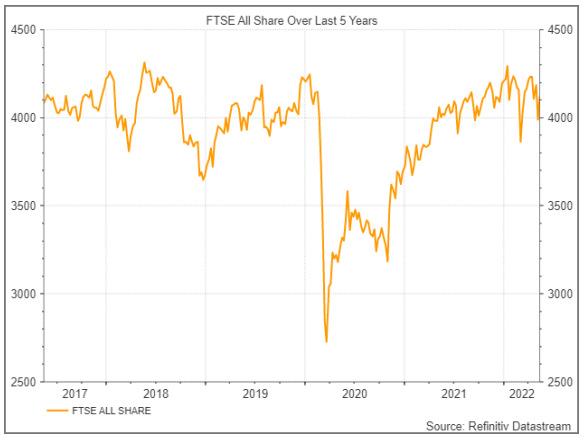
The war in Ukraine and the sanctions applied to Russia have both directly contributed to a further increase in inflation. Russia is the world’s second largest natural gas producer and the third largest producer of oil. Russia and

Ukraine together also supply more than 25% of the world's wheat and are both key suppliers of other agricultural and industrial commodities. Energy and commodity prices, that had already risen globally as a result of Covid-19 pandemic related supply disruptions, have been squeezed higher. The Bloomberg Commodity Index has risen over 31% so far in 2022 and is trading at a 7-year high, having already climbed 28% in 2021.

In the UK, the year-on-year CPI came in at 7.0% in March and 9.0% in April. In the US, CPI peaked at 8.5% in March, moderating slightly to 8.3% in April. Both the BoE and US FED announced further interest rate increases in their March and May meetings. In recent days, the BoE's chief economist signalled that he was unsure how high interest rates will need to rise to curb inflation, and the Federal Reserve Chairman stated that he was prepared to keep tightening monetary policy until there was "clear and convincing" evidence that inflation is coming back down towards its 2% target.

In the year-to-date period to 16 May 2022, Global Equity markets, as measured by the FTSE All World, have returned -7.0% in sterling terms. In US dollar terms the return is -15.9%, as the dollar has strengthened 9% against sterling this year. Protection Assets have been unable to offset negative returns from equities due to the sharp rise in bond yields. The 10 Year Gilt yield has risen by approximately 75 basis points to 1.75% since the start of the year, with Gilts returning -8.6% during the period.

Asset class weightings and recommendations are based on values at the end of April 2022. As shown in the charts below, UK equity markets had largely recovered most of the March 2020 sell off prior to Russia's invasion of Ukraine. Equity markets have been volatile in 2022, but UK Equities have performed strongly relative to other markets, having fallen by only 0.7%. In contrast, the US market has been the worst performing region in 2022 in local currency terms, declining by 16.1%, reflecting its relatively heavy weighting in technology and other growth-related stocks.



2.5 Longer Term Performance

Figures provided by Portfolio Evaluation Limited show the Fund's performance over 1, 3, 5 and 10 years to 31 March 2022.

Per annum	DPF	Benchmark Index
1 year	7.6%	7.3%
3 years	7.4%	6.9%
5 years	6.3%	5.9%
10 years	8.4%	7.9%

The Fund outperformed the benchmark over all time periods.

2.6 Category Recommendations

	Intermediate Benchmark	Final Benchmark	Fund Allocation	Permitted Range	Recommendation (1)		Benchmark Relative Recommendation (1)	
			30 Apr-22		AF	DPF	AF	DPF
Growth Assets	56.0%	55.0%	55.3%	± 8%	55.0%	55.0%	-	-
Income Assets	24.0%	25.0%	24.2%	± 6%	27.0%	24.2%	+2.0%	(0.8%)
Protection Assets	18.0%	18.0%	16.0%	± 5%	16.0%	16.5%	(2.0%)	(1.5%)
Cash	2.0%	2.0%	4.5%	0 – 8%	2.0%	4.3%	-	+2.3%

(1) Recommendation relative to the Final benchmark effective 1 January 2022

At an overall level, the Fund was overweight Growth Assets and Cash at 30 April 2022, underweight Income Assets and Protection Assets, although if commitments waiting to be drawn down were taken into account, the Fund would move to an overweight position in Growth and Income Assets. The table on page 3 assumes that all new commitments will be funded out of the current cash weighting; in practice as private market commitments are drawn-down they are likely to be funded partially out of cash and partially by distributions (income and capital) from existing investments and sales of public market assets. The Fund has progressively reduced its benchmark exposure to Growth Assets into strength over the last three to five years, as equity valuations have become increasingly stretched, and increased the benchmark allocation to Income Assets.

The IIMT recommendations reflected in this report: reduce Growth Assets by 0.3% to 55.0% (neutral) (North American Equities -1.6%; European Equities -0.5%; Japanese Equities +0.4%; Asia Pacific Ex-Japan Equities -0.9%; Emerging Market Equities +0.9%; and Global Sustainable Equities +1.4%), maintain Income Assets at 24.2% (Multi-Asset Credit -0.7%; Infrastructure +0.1%; and Direct Property +0.6%); increase Protection Assets by 0.5% (Conventional Bonds +0.5%), and reduce cash by 0.2%.

The IIMT notes that the recommendations are subject to market conditions, liquidity, and product availability. The IIMT continues to recommend a defensive cash allocation, reflecting both the general market uncertainty and cash held to fund existing commitment drawdowns.

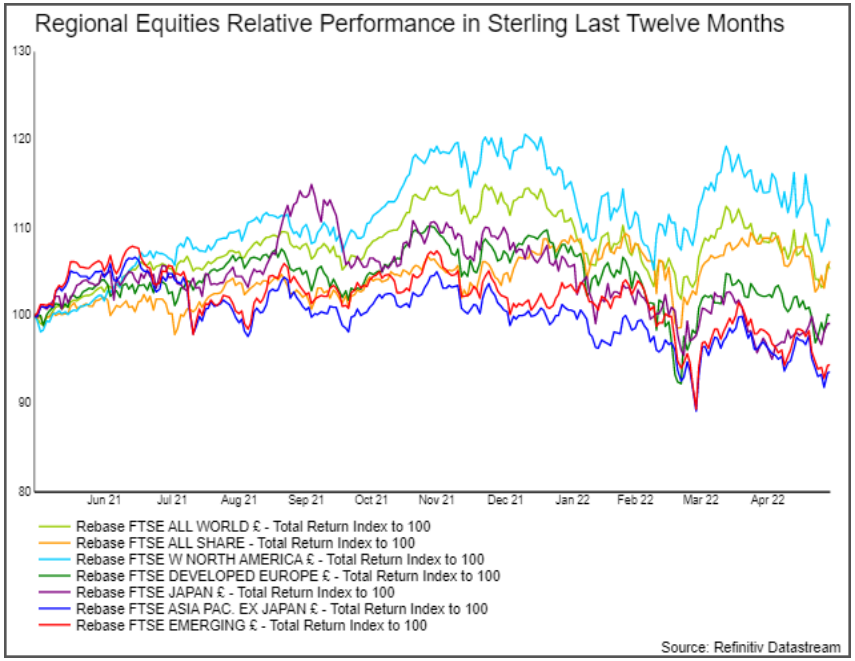
2.7 Growth Assets

At 30 April 2022, the overall Growth Asset weighting was 55.3%, down from 55.9% at 31 January 2022, principally reflecting net divestment of around £25m. During the three months to 30 April 2022, the Fund continued to make progress in the transition to the new final SAAB, with £70m invested into Global Sustainable Equities, funded from divestments in respect of North American Equities and European Equities.

The IIMT recommendations in this report reduce the weighting to a neutral weighting of 55.0%.

The near-term outlook for equities has deteriorated since the last Committee meeting. The primary risk factors have also changed. In Developed Markets, the threat from Covid-19 has reduced as the Omicron variant, although more transmissible, has proven to have less severe health implications and booster campaigns have demonstrated their effectiveness. However, the lack of access to effective vaccines has been felt in in Emerging Markets, particularly in China, where a new wave of cases has resulted in some cities being placed back into strict lockdowns as authorities attempt to achieve zero Covid-19 status.

Globally, inflationary pressures have intensified. Despite four rate rises by the BoE and two by the US FED, there is limited evidence to date that inflation has peaked. Supply constraints from the war in Ukraine, and the potential disruption from China's lockdowns are expected to continue to exert upward pressure on prices. Tighter monetary policy alone has a limited ability to control supply-side inflation.

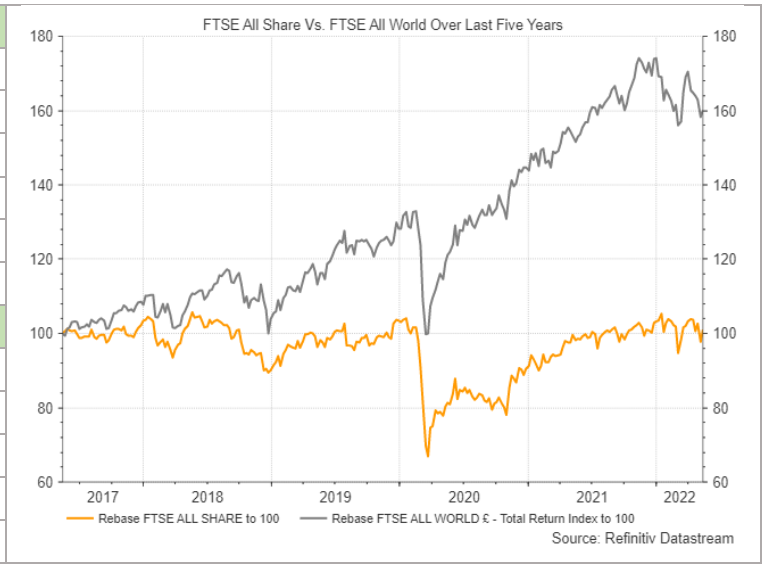


Benchmark Return	Currency	Q2-22(*)	Q1-22	CYTD (*)	1 Year (**)	3 Year (**)	5 Year (**)	Since Last Committee (*)	L3M 30-Apr-22
Sterling Returns									
FTSE All World	GB£	(4.7%)	(2.4%)	(7.0%)	12.8%	13.8%	11.0%	(1.1%)	(1.9%)
FTSE UK	GB£	(1.2%)	0.5%	(0.7%)	13.0%	5.3%	4.7%	0.7%	1.1%
FTSE North America	GB£	(5.3%)	(2.0%)	(7.3%)	19.7%	18.4%	14.6%	(1.2%)	(2.1%)
FTSE Europe	GB£	(4.3%)	(7.2%)	(13.4%)	6.2%	9.6%	7.1%	(1.0%)	(6.2%)
FTSE Japan	GB£	(3.1%)	(3.5%)	(6.5%)	(2.3%)	6.5%	5.2%	(0.9%)	(3.8%)
FTSE Asia Pacific Ex-Japan	GB£	(4.5%)	(2.2%)	(6.6%)	(4.3%)	7.1%	6.3%	(3.3%)	0.3%
FTSE Emerging Markets	GB£	(4.7%)	(2.5%)	(7.1%)	(3.5%)	5.7%	5.5%	(5.5%)	(3.6%)
Local Currency Returns									
FTSE All World	US$	(11.4%)	(5.1%)	(15.9%)	7.6%	14.2%	12.1%	(9.0%)	(8.2%)
FTSE UK	GB£	(1.2%)	0.5%	(0.7%)	13.0%	5.3%	4.7%	0.7%	1.1%
FTSE North America	US$	(11.9%)	(4.8%)	(16.1%)	14.2%	18.8%	15.8%	(9.0%)	(8.4%)
FTSE Europe	€	(4.8%)	(10.0%)	(14.4%)	4.7%	9.5%	7.0%	(3.0%)	(6.7%)
FTSE Japan	¥	(4.1%)	(1.2%)	(5.2%)	2.4%	10.2%	8.1%	1.8%	1.3%
FTSE Asia Pacific Ex-Japan	US$	(11.1%)	(4.9%)	(15.5%)	(8.7%)	7.5%	7.4%	(11.0%)	(6.2%)
FTSE Emerging Markets	US$	(11.3%)	(5.2%)	(15.9%)	(7.7%)	6.1%	6.7%	(13.0%)	(9.8%)

Source: Performance Evaluation Limited & DPF analysis
(*) To 16 May-22
(**) To 31 Mar-22
(***) 50% FTSE All World & 50% FTSE Developed
CYTD = Calendar Year To Date

2.8 United Kingdom Equities

DPF Weightings	
Intermediate Neutral	14.0%
Final Neutral	12.0%
Actual 30.4.22	13.5%
AF Recommendation	12.0%
IIMT Recommendation	13.5%
Benchmark Returns (GB£)	
Q1 22/23 to 1 May-22	(1.2%)
Q4 21/22	0.5%
1 Year to Mar-22	13.0%
3 Years to Mar-22 (pa)	5.3%
5 Years to Mar-22 (pa)	4.7%



The Fund's UK Equity allocation increased from 13.2% at 31 January 2022 to 13.5% at 30 April 2022 (1.5% overweight), reflecting relative market strength.

Mr Fletcher has recommended a neutral weighting of 12.0% to UK Equities.

For some time now, the IIMT have been recommending an overweight allocation to UK Equities because of their attractive valuations and sector diversification. Despite the significant correction in Global Equities, the FTSE All Share has retained much of its value. Although the FTSE All Share has fallen year to date (-0.7% to 16 May 2022), it has outperformed the FTSE All World by +6.3% (in sterling terms).

The UK FTSE All Share has benefitted from the style rotation from Growth stocks to Value stocks. The FTSE All Share is overweight the Energy sector and considerably underweight the Technology sector, relative to the FTSE All World, which have been the best and worst performing sectors in 2022. Lower valuations have also been a tailwind for UK companies, as they have been less susceptible to the compression of earnings multiples that has occurred across the more expensive areas of the market, particularly in US Growth stocks.

As there is still uncertainty around when inflation will start to fall, and how far interest rates may need to rise, the IIMT continue to believe that UK Equities have the potential to outperform, supported by attractive valuations and diversified sector exposure. The IIMT recommends that the current 1.5%

overweight allocation of 13.5% relative to the final benchmark is maintained, with a modest tilt towards small and mid-cap stocks.

2.9 North American Equities

DPF Weightings	
Intermediate Neutral	6.0%
Final Neutral	-
Actual 30.4.22	1.6%
AF Recommendation	-
IIMT Recommendation	-
Benchmark Returns (GB£)	
Q1 22/23 to 16 May-22	(5.3%)
Q4 21/22	(2.0%)
1 Year to Mar-22	19.7%
3 Years to Mar-22 (pa)	18.4%
5 Years to Mar-22 (pa)	14.6%

The Fund's North American Equity allocation remained flat between 31 January 2022 and 30 April 2022 at 1.6% (1.6% overweight).

Both Mr Fletcher and the IIMT recommended a zero-weighting to North American Equites in line with the new final benchmark.

2.10 European Equities

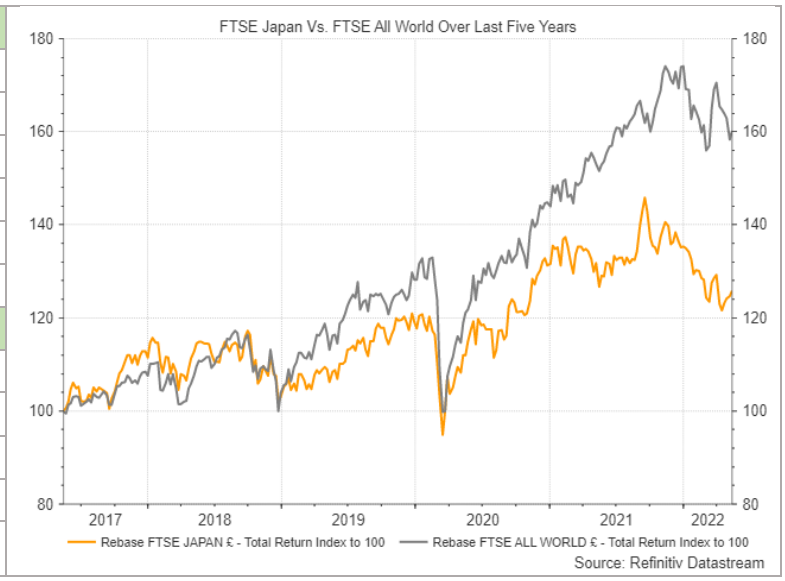
DPF Weightings	
Intermediate Neutral	4.0%
Final Neutral	-
Actual 30.4.22	0.5%
AF Recommendation	-
IIMT Recommendation	-
Benchmark Returns (GB£)	
Q1 22/23 to 16 May-22	(4.3%)
Q4 21/22	(7.2%)
1 Year to Mar-22	6.2%
3 Years to Mar-22 (pa)	9.6%
5 Years to Mar-22 (pa)	7.1%

The Fund's European Equity allocation remained flat between 31 January 2022 and 30 April 2022 at 0.5% (0.5% overweight).

Both Mr Fletcher and the IIMT recommended a zero-weighting to European Equities in line with the new final benchmark.

2.11 Japanese Equities

DPF Weightings	
Intermediate Neutral	5.0%
Final Neutral	5.0%
Actual 30.4.22	5.1%
AF Recommendation	5.0%
IIMT Recommendation	5.5%
Benchmark Returns (GB£)	
Q1 22/23 to 16 May-22	(3.1%)
Q4 21/22	(3.5%)
1 Year to Mar-22	(2.3%)
3 Years to Mar-22 (pa)	6.5%
5 Years to Mar-22 (pa)	5.2%



Relative market weakness reduced the Fund's allocation to Japanese Equities from 5.3% at 31 January 2022 to 5.1% at 30 April 2022.

Mr Fletcher recommends a neutral weighting relative to the final benchmark.

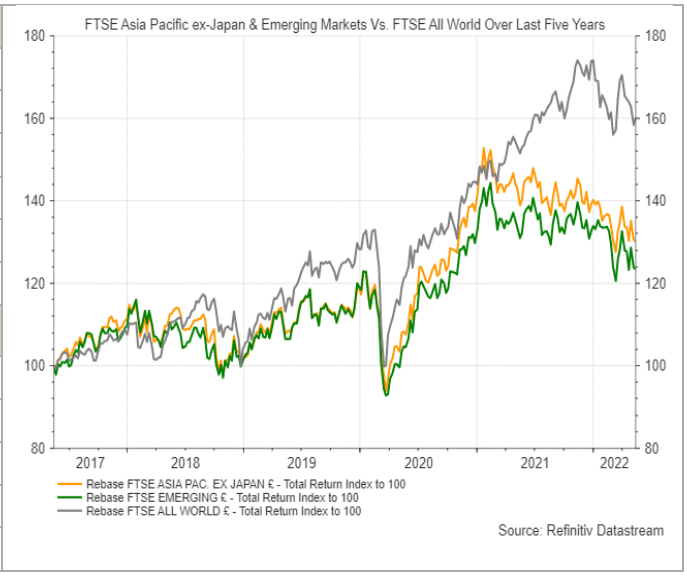
Japanese Equities continue to perform in line with the IIMT's expectations, offering meaningful diversification during period of increased uncertainty. In local currency terms, Japanese Equities have performed strongly against a backdrop of a sharp correction in Global Equities. The Japanese index has benefitted from lower valuations and sector diversification in comparison to the FTSE All World.

The Japanese Yen is traditionally viewed as a safe haven asset which rises in value during periods of market uncertainty, increasing returns for sterling investors. However, due to the divergence between US and Japanese bond yields since the turn of the year, the Yen has depreciated, which has lowered returns for sterling investors.

The IIMT believes that Japanese Equities remain attractively valued relative to their global peers and recommends that the Fund's overweight allocation is increased by 0.4% to 5.5% (0.5% overweight).

2.12 Asia Pacific Ex-Japan and Emerging Market Equities

DPF Weightings	Asia-Pac	EM
Intermediate Neutral	2.0%	5.0%
Final Neutral	-	5.0%
Actual 30.4.22	0.9%	4.7%
AF Recommendation	-	5.0%
IIMT Recommendation	-	5.6%
Benchmark Returns (GB£)	**Asia-Pac**	**EM**
Q1 22/23 to 16 May-22	(4.5%)	(4.7%)
Q4 21/22	(2.2%)	(2.5%)
1 Year to Mar-22	(4.3%)	(3.5%)
3 Years to Mar-22 (pa)	7.1%	5.7%
5 Years to Mar-22 (pa)	6.3%	5.5%



The Fund's allocation to Asia Pacific Ex-Japan Equities remained flat at 0.9% (0.9% overweight), whereas relative market weakness reduced the Fund's allocation to Emerging Market Equities by 0.4% to 4.7% (0.3% underweight).

Mr Fletcher recommends a zero-weighting relative to Asia Pacific Ex-Japan Equities in line with the final benchmark, and a neutral allocation of 5.0% to Emerging Market Equities.

Emerging Market Equities have been the worst performing region so far in 2022. However, returns between the Emerging Market regions have varied significantly. China is currently facing a new wave of Covid-19 cases (thought to be due to low vaccination rates and less effective vaccines) and the Chinese authorities have reintroduced lockdowns in several major cities. In Sterling terms, Chinese equities have lost almost 16% year to date. In contrast, Latin American Equities have retuned over 21% during the same period. The region is a net exporter of commodities and has been a major beneficiary from the sharp rise in commodity prices.

Russia was removed from the Emerging Markets index shortly after its invasion of Ukraine, with the country being viewed as uninvestable. Russian equities made up approximately 4% of the Emerging Markets index at the start of the year. There has also been a contagion effect from the conflict, with eastern European countries most heavily affected due to their close proximity and trading ties to Russia and Ukraine.

The IIMT continues to believe in the long-term growth potential of Emerging Markets, noting that these markets have accounted for well over half of global growth over the last ten years. The IIMT believes that Emerging Market Equities offer value relative to their global peers, a position that has been enhanced during the current market sell-off. The IIMT therefore recommends an overweight allocation of 5.6% (0.6% overweight).

2.13 Global Sustainable Equities

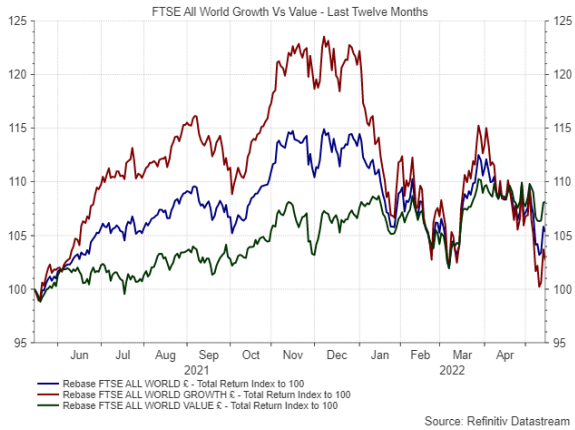
DPF Weightings	
Intermediate Neutral	16.0%
Final Neutral	29.0%
Actual 30.4.22	24.2%
AF Recommendation	29.0%
IIMT Recommendation	25.6%
Benchmark Returns (GB£)	
Q1 22/23 to 16 May-22	(1.9%)
Q4 21/22	(2.7%)
1 Year to Mar-22	13.4%
3 Years to Mar-22 (pa)	14.1%
5 Years to Mar-22 (pa)	11.0%

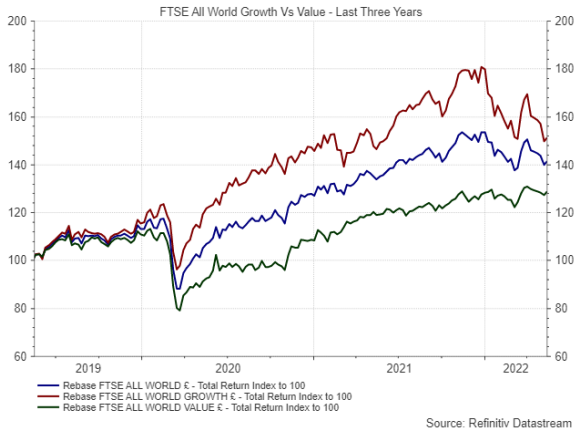
The Fund's allocation to Global Sustainable Equities fell from 24.6% at 31 January 2022 to 24.2% at 30 April 2022 reflecting relative market weakness.

Mr Fletcher recommends a neutral weighting of 29.0% relative to the final benchmark.

The IIMT remains confident about the long-term investment case for the Fund's allocation to Global Sustainable Equities, which typically favour growth stocks relative to value stocks.

The charts below shows that growth stocks have out-performed value stocks over the last three years, particularly since the start of the Covid-19 pandemic, as investors favoured quality growth stocks over pro-cyclical stocks, in part supported by low forward interest rate expectations.





However, value stocks have rallied over the last twelve months as both economic activity, and in particular, forward interest rate expectations have increased. This trend has continued into 2022, with investors favouring tangible (or 'real') assets over intangible assets. There has also been a shift from green energy (i.e. renewables) to brown energy (i.e. fossil fuels).

Whilst the IIMT believes that the current value rally may continue for several more months to come (driven by rising forward rate expectations and increased geopolitical tensions), the IIMT remains confident that the Fund's allocation to Global Sustainable Equities will out-perform over the long-term.

To reduce the performance risk of increasing allocations within a highly correlated asset class, the calendar year-to-date increase in the Fund's Global Sustainable Equity allocation from 16.9% at 31 December 2021 to 24.2% at 30 April 2022 (inward investment of around £500m) has been targeted at highly diversified index products which are designed to significantly reduce the carbon footprint of the portfolio but also to dampen-down performance volatility relative to the wider market.

The IIMT recommends that Fund's allocation to Global Sustainable Equities is increased to 25.6%; 3.4% underweight. As noted earlier, the IIMT recommends an overall neutral weight to Growth Assets, with the underweight in respect of Global Sustainable Equities being used to fund overweight allocations in respect of UK Equities, Japanese Equities, Emerging Market Equities and Private Equity. The IIMT believes that these allocations offer greater relative value.

2.14 Private Equity

DPF Weighting					
Intermediate Netural	Final Neutral	Actual 30.4.22	Committed 30.4.22	AF Recommendation	IIMT Recommendation
4.0%	4.0%	4.8%	5.8%	4.0%	4.8%
Benchmark Returns (GB£)					
Q1 22/23 to 16 May-22	Q4 21/22	1 Year to May-22	3 Years to May-22 (pa)	5 Years to May-22 (pa)	
(1.7%)	(2.5%)	10.4%	5.2%	5.0%	

The Private Equity weighting increased from 4.7% at 31 January 2022 to 4.8% at 30 April 2022 (0.8% overweight relative to the final benchmark), reflecting relative market strength.

Mr Fletcher recommends a neutral weighting of 4.0% in Private Equity.

The IIMT notes that the Fund is overweight to Private Equity on a committed basis and is not reviewing further opportunities at this stage. The IIMT believes that the Fund's outstanding private equity commitments of around £60m are well positioned to benefit from any market opportunities resulting from the recovery from the coronavirus outbreak with a strong focus on small and mid-cap deals.

The IIMT recommends maintaining the current Private Equity allocation of 4.8% (0.8% overweight); 5.8% on a committed basis. The IIMT believes that recent relative market weakness should help the asset class to outperform over the longer term.

It is noted that the Fund changed its Private Equity benchmark from FTSE All Share +1% to Global Sustainable Equity +1% on 1 January 2022 to reflect the increasing global nature of the Fund's private equity investments and better evaluate performance relative to the Fund's Global Sustainable Equity allocation.

2.15 Income Assets

At 30 April 2022, the overall weighting in Income Assets was 24.2%, 2.0% higher than that reported at 31 January 2022, reflecting net investment of £96m, together with relative market strength. The IIMT recommendations below maintain the overall Income Asset weighting at 24.2%; 28.2% on a committed basis.

2.16 Multi Asset Credit

DPF Weighting				
Intermediate Neutral	Final Neutral	Actual 30.4.22	AF Recommendation	IIMT Recommendation
6.0%	6.0%	6.9%	8.0%	6.2%
Benchmark Returns (GB£)				
Q3 22/23 to 16 May-22	Q4 21/22	1 Year to May-22	3 Years to May-22 (pa)	5 Years to May-22 (pa)
0.1%	(0.2%)	2.2%	3.5%	3.5%

The Fund's allocation to Multi-Asset Credit reduced from 7.0% at 31 January 2022 to 6.9% at 30 April 2022, principally reflecting net distributions of £5m; 0.9% overweight relative to the final benchmark.

It is noted that subsequent to 30 April 2022, the Fund finalised a commitment of £56.25m to a European private debt fund managed by CVC Capital Partners (CVC Capital Partners European Direct Lending Fund III). The fund will provide senior secured private debt financing to private equity backed transactions and is targeting an annual net return of around 7%, with an average annual net cash yield of around 5%. As the commitment was time critical and in excess of £25m, the commitment was approved by the Interim Director of Finance & ICT in consultation with the Chair of the Pensions and Investments Committee.

Mr Fletcher recommends a 2.0% overweight allocation of 8.0% to Multi-Asset Credit, funded from a 1.0% underweight allocation to both conventional UK gilts and investment grade bonds (see Protection Assets). Mr Fletcher notes that whilst credit spreads are low, corporate fundamentals remain strong and default rates are likely to remain low. Furthermore, because many of the securities within a Multi-Asset Credit portfolio have floating rather than fixed interest rates, they are less interest rate sensitive, which is preferable in a rising rate environment.

The IIMT continues to be positive about the long-term attractions of the asset class and favours a strong bias towards defensive forms of credit (e.g., senior secured debt and asset backed securities). The noted new private debt commitment is part of a planned change in the portfolio mix away from diversified Multi-Asset Credit funds, which have lower levels of debt security, towards senior secured debt funds.

Notwithstanding the long-term attractions of the asset class, the IIMT recommends that the current allocation of 6.9% is reduced to 6.2% (0.2% overweight; 8.4% on a committed basis) to rebalance the Fund's Income Asset portfolio which has been impacted by recent investment into Direct Property (£22m) and Infrastructure (£94m).

2.17 Property

DPF Weighting				
Intermediate Neutral	Final Neutral	Actual 30.4.22	AF Recommendation	IIMT Recommendation
9.0%	9.0%	8.0%	9.0%	8.6%
Benchmark Returns (GB£)				
Q1 22/23 to 16 May-22	Q4 21/22	1 Year to May-22	3 Years to May-22 (pa)	5 Years to May-22 (pa)
Not Available	3.9%	19.5%	6.7%	6.8%

The Fund's allocation to Property increased by 0.3% to 8.0% at 30 April 2022, reflecting net investment of £8m (+£22m Direct Property / -£14m Indirect Property, reflecting redemptions from two funds in unwind) and relative market strength. Direct Property accounted for 5.1% (up 0.5%, 0.9% underweight relative to the final benchmark) and Indirect Property accounted for 2.9% (down 0.2%, 0.1% underweight relative to the final benchmark).

The Fund purchased two direct properties, and sold one direct property, in the period at a net cost of £22m. The Fund completed the purchase of a freehold multi-let industrial estate in Leighton Buzzard for £16.1m and a retail warehouse park on a long leasehold in Reading for £10.4m.

Mr Fletcher recommends a neutral overall allocation of 9.0% to property but notes that he would like to see the Direct Property allocation increased, funded from realisations out of the Indirect Property allocation. However, Mr Fletcher acknowledges that this should be done with caution as it is a very long-term investment decision, and property transactions tend to be quite expensive.

The total return of the Fund's property portfolio for the year to 31 March 2022 was 18.8%. The Fund's Discretionary Direct Property manager notes that the UK commercial property market had a strong end to both the calendar year 2021 and financial year 2021-22, but with economic headwinds increasing not least in the form of a rapidly rising inflation rate and further expected increases in interest rates, returns are likely to ease going forward. The industrial and retail warehousing sectors are forecast to provide the strongest total return performance over the medium term and the Fund has good exposure to these sectors. The standard shops and office sectors still require caution before considering additional investment, due to consumer confidence looking more fragile as energy and food costs increase (retail) and an evolving post-Covid working environment (offices).

The Fund's manager is of the opinion that further investment in the alternatives sector (e.g., leisure and hotels) merits consideration. The Fund has a lower weighting in this sector relative to the benchmark and a rebound in values is anticipated as the sector recovers from a low base as a result of the Covid related challenges over the past two years.

The Direct Property Manager has recently agreed Heads of Terms to acquire two further properties for a total of £35m which are scheduled to complete in Q2-22.

The IIMT recommends that the Fund's allocation to Direct Property is increased to 5.7% to reflect the net impact of the purchases noted above (0.3% underweight), whereas the allocation to Indirect Property is maintained at 2.9% (0.1% overweight). It is also recommended that further liquidity of up to £30m is made available to the Direct Property manager to make incremental investments at the right time should suitable investment opportunities be identified.

The IIMT continues to believe that Indirect Property increases the options available to the Fund to deploy capital into a relatively illiquid asset class and increases portfolio diversification, including exposure to overseas assets, private rented accommodation, student accommodation, development capital and medical centres.

2.18 Infrastructure

DPF Weighting					
Intermedidate Neutral	Final Neutral	Actual 30.4.22	Committed 30.4.22	AF Recommendation	IIMT Recommendation
9.0%	10.0%	9.3%	11.2%	10.0%	9.4%
Benchmark Returns (GB£)					
Q1 22/23 to 16 May-22	Q4 21/22	1 Year to May-22	3 Years to May-22 (pa)	5 Years to May-22 (pa)	
0.3%	0.6%	2.2%	2.4%	2.5%	

The Fund's allocation to Infrastructure increased from 7.5% at 31 January 2022 to 9.3% at 30 April 2022 principally reflecting net investment of around £94m, of which £74m related to renewable energy assets.

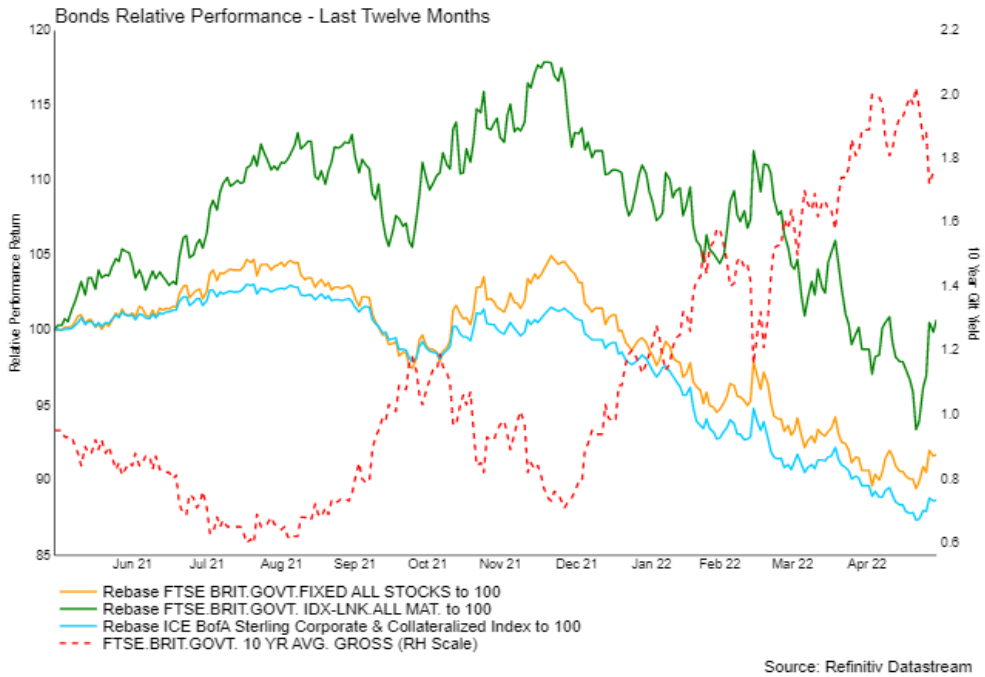
Mr Fletcher recommends a neutral weighting relative to the final benchmark of 10.0% allocation, although Mr Fletcher acknowledges that because of the nature of the infrastructure investment process, it takes time to deploy capital to the asset class.

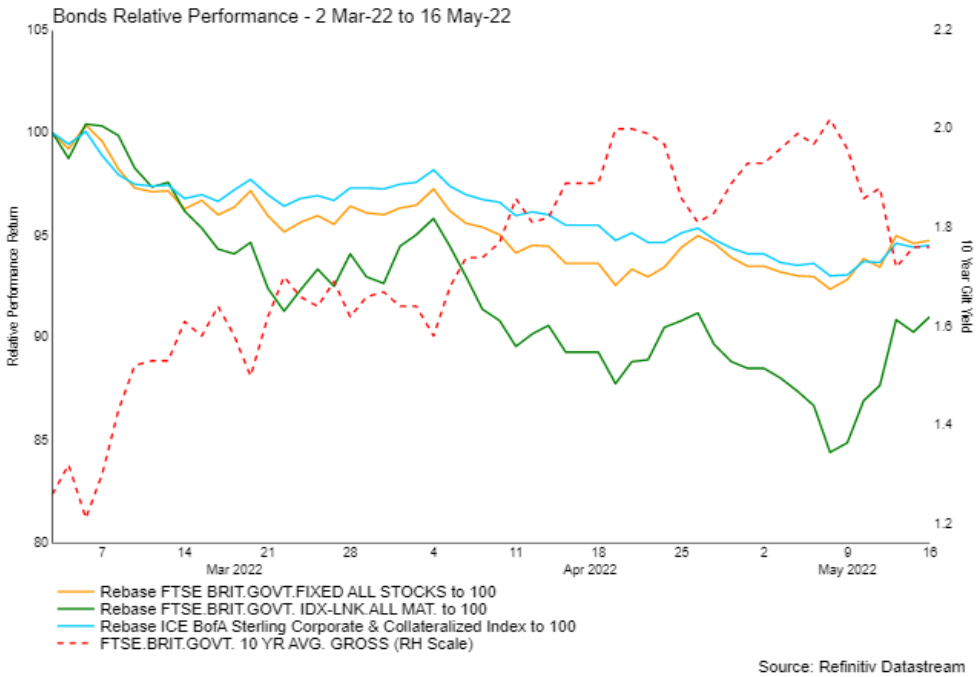
The IIMT continues to view Infrastructure as an attractive long-term asset class and favours a bias towards core infrastructure assets or renewable energy assets. These assets can offer low volatility; low correlation to equity and fixed income markets; and reliable long-term cash flows.

Notwithstanding the noted favourable long-term characteristics of the asset class, the IIMT continues to believe that infrastructure assets are exposed to increased political and regulatory risk, and this risk is best mitigated through asset type and geographical diversification. It should also be noted that the current market valuation of some infrastructure assets, particularly renewable infrastructure assets, are becoming increasingly stretched driven by strong investor demand.

The IIMT recommends that the invested weighting is increased by 0.1% to 9.4% in the next quarter, reflecting anticipated closed-ended fund drawdowns; 11.2% on a committed basis.

2.19 Protection Assets



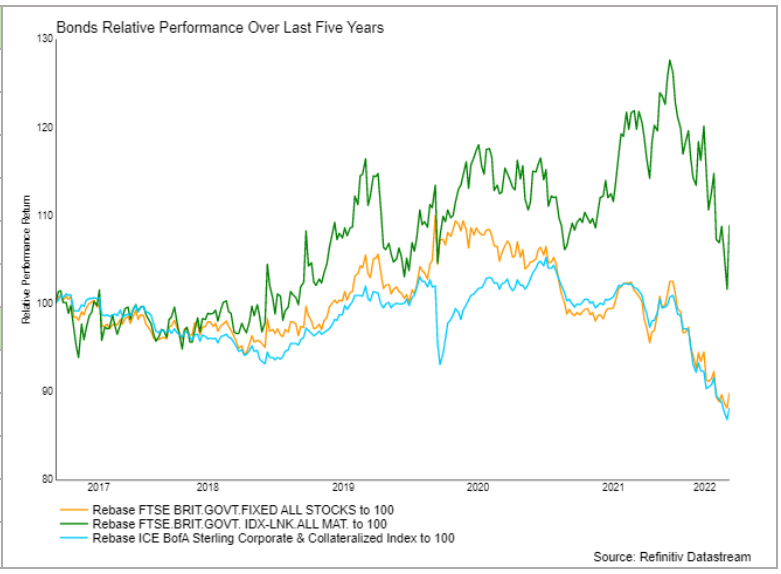


The weighting in Protection Assets at 30 April 2022 was 16.0%, 0.8% lower than 31 January 2022 reflecting relative market weakness, partly offset by net investment of £9m. The IIMT recommendations below increase the weighting by 0.5% to 16.5%.

Fixed income returns have come under increasing pressure in 2022 as bond yields have risen (reflecting how prices have fallen). Expectations for the path of monetary policy have seen a major shift this year, with markets now pricing in interest rates of well over 2% in both the US and the UK by year-end, as rates are normalised from historic lows to tackle rising inflation

2.20 Conventional Bonds

DPF Weightings	
Intermediate Neutral	6.0%
Final Neutral	6.0%
Actual 30.4.22	4.5%
AF Recommendation	5.0%
IIMT Recommendation	5.0%
Benchmark Returns (GB£)	
Q1 22/23 to 16 May-22	(1.6%)
Q4 21/22	(7.2%)
1 Year to Mar-22	(5.1%)
3 Years to Mar-22 (pa)	(0.5%)
5 Years to Mar-22 (pa)	0.5%



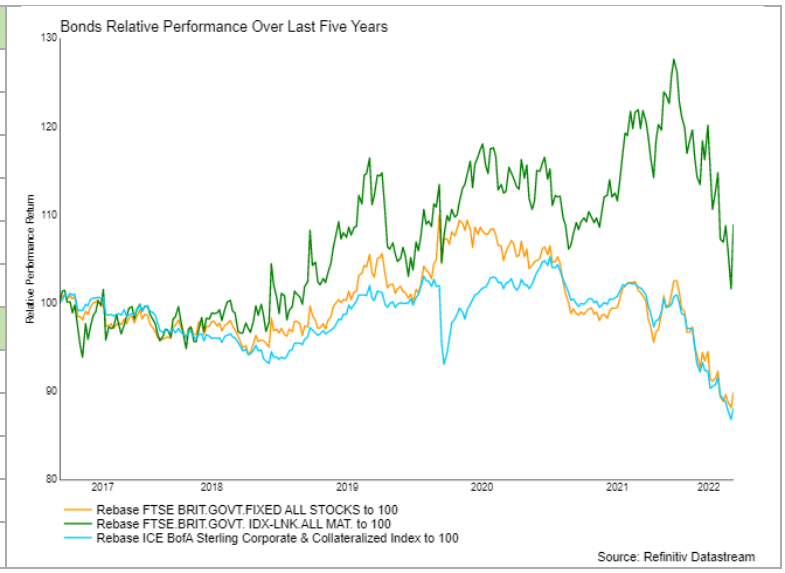
The Fund's allocation to Conventional Bonds reduced by 0.3% to 4.5% between 31 January 2022 and 30 April 2022, reflecting net divestment of £11m and relative market weakness; 1.5% underweight relative to the final benchmark.

Mr Fletcher has reduced his recommended underweight allocation to Conventional Bonds from 2.0% to 1.0%. Mr Fletcher notes that higher inflation and interest rates will continue to exert negative pressure on bond markets, but on balance, yields for government bonds are now sufficiently attractive to reduce the previous underweight allocation of 2.0% to 1.0%.

The IIMT agrees that conventional sovereign bonds offer better value now than they have for some time following the sharp rise in yields from recent historic lows. Sovereign bonds are also diversifying assets which should afford greater protection than other asset classes in periods of market uncertainty, as evidenced during the Covid-19 pandemic. The IIMT recommends increasing the weighting by 0.5% to 5.0%; 1.0% underweight relative to the final benchmark.

2.21 Index-Linked Bonds

DPF Weightings	
Intermediate Neutral	6.0%
Final Neutral	6.0%
Actual 30.4.22	5.5%
AF Recommendation	6.0%
IIMT Recommendation	5.5%
Benchmark Returns (GB£)	
Q1 22/23 to 16 May-22	(3.5%)
Q4 21/22	(5.5%)
1 Year to Mar-22	5.1%
3 Years to Mar-22 (pa)	3.2%
5 Years to Mar-22 (pa)	3.1%



The Fund's allocation to Index-Linked Bonds remained flat at 5.5% (0.5% underweight relative to the final benchmark) with net investment of £20m being offset by market weakness. The Fund's allocation at 30 April 2022 comprised 80% UK Index-Linked Bonds (UK Linkers) and 20% US Treasury Inflation Protected Bonds (US TIPS).

Mr Fletcher has maintained his 6.0% (neutral) allocation to Index-Linked Bonds. Mr Fletcher notes that he remains uncomfortable with the extremely high duration, negative yield and over-valuation of index-linked gilts, and has consistently recommended an underweight allocation in the past. However, in the current market environment of rising inflation, Mr Fletcher now recommends a neutral position.

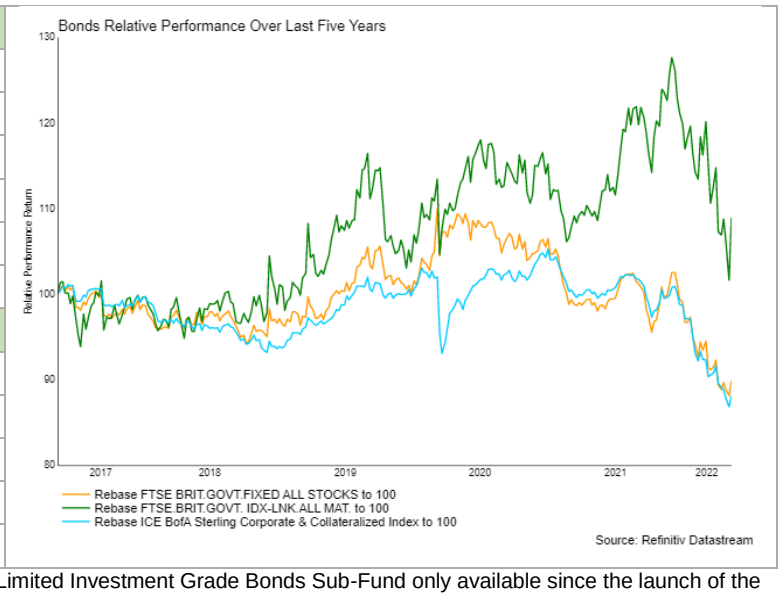
The IIMT notes that markets and the major central banks have become increasingly concerned about higher inflation, which has been driven by the 'post Covid-19' economic recovery; supply constraints; high-savings rates (which could reverse and lead to a spending surge); previous central bank policy stimulus; higher energy costs; and the conflict between Russia and Ukraine. However, it is unclear whether this will be a relatively short-term issue or whether inflationary pressures will become more entrenched.

The IIMT believes that the potential for a longer-term period of elevated inflation supports the Fund's current Index-Linked bonds allocation, and therefore recommends that the weighting is maintained at 5.5%. The IIMT

recommends maintaining the Fund's current exposure to US TIPS, noting that these offer diversification and protection against rising US inflation expectations.

2.22 Corporate Bonds

DPF Weightings	
Intermediate Neutral	6.0%
Final Neutral	6.0%
Actual 30.4.22	6.0%
AF Recommendation	5.0%
IIMT Recommendation	6.0%
Benchmark Returns (GB£)	
Q1 22/23 to 16 Mar-22	(3.9%)
Q4 21/22	(6.7%)
1 Year to Mar-22	(4.9%)
3 Years to Mar-22 (pa) (1)	n/a
5 Years to Mar-22 (pa) (1)	n/a



(1) Benchmark returns for the LGPS Central Limited Investment Grade Bonds Sub-Fund only available since the launch of the product in February 2020

There were no transactions in the period and relative market weakness reduced the Fund's weighting in Global Investment Grade Bonds from 6.5% at 31 January 2022 to 6.0% at 30 April 2022.

Mr Fletcher has increased his recommended weighting in Global Investment Grade Bonds from 4.0% (2.0% underweight) to 5.0% (1.0% underweight) on the basis that the recent sell off of investment grade bonds has increased the relative attractiveness of the asset class.

The IIMT notes that investment grade bond spreads have now increased to the level of long-term averages, albeit it remains unclear whether these fully compensate for the increased level of credit risk. However, the IIMT believes that investment grade bonds are likely to be more defensively positioned relative to risk-on assets (e.g., equities, high yield bonds, etc), should markets experience a prolonged period of weakness. As a result, the IIMT recommends maintaining the current neutral allocation of 6.0% to the asset class.

2.23 Cash

The Cash weighting at 30 April 2022 was 4.5% (2.5% overweight relative to the final benchmark), down from 5.1% at 31 January 2022.

Mr Fletcher has reduced his recommended weighting in Cash from 4.0% (2% overweight) to 2% (neutral), with the reduction used to fund a 1.0% increase in the Fund's allocations to both Conventional Bonds and Corporate Bonds

The IIMT notes that global markets are extremely volatile; investor confidence is low with multiple factors weighing on investor sentiment, including a slowdown in global activity, inflationary pressures, rising interest rates, energy security concerns, tight global supply chains, the conflict between Russia and Ukraine and China's zero Covid-19 policy.

The IIMT recommends a defensive cash allocation of 4.3% (2.3% overweight relative to the final benchmark) due to the uncertain economic outlook. This will also ensure that the Fund has sufficient operational headroom after adjusting for term-loan maturities (i.e., short-term loans provided by the Fund to other public sector bodies) to cover upcoming investment commitment drawdowns (expected to be in excess of £180m over the course of 2022-23).

3. Implications

3.1 Appendix 1 sets out the relevant implications considered in the preparation of the report.

4. Background Papers

4.1 Papers held in the Investment Section.

5. Appendices

5.1 Appendix 1 – Implications
5.2 Appendix 2 – Report of independent external adviser.
5.3 Appendix 3 – Portfolio Valuation Report at 30 April 2022.

6. Recommendation(s)

That Committee:

a) notes the report of the independent external advisor, Mr Fletcher.
b) notes the asset allocations, total assets and long-term performance analysis set out in the report.
c) notes the change to the Fund's Private Equity benchmark from FTSE All Share +1% to Global Sustainable Equities +1%.
d) notes the commitment of £56.25m to CVC Credit Partners European Direct Lending Fund III.
e) approves the IIMT recommendations outlined in the report.

7. Reasons for Recommendation(s)

7.1 Both Mr Fletcher's report and the analysis set out in this report in respect of asset allocation, total assets and long-term performance provide an overview of the Fund's investment strategy and performance track-record on which to assess the asset allocation recommendations for the Fund for the upcoming quarter.

7.2 The rationale for each of the IIMT asset allocation recommendations included in this report is set out in Section 2.

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Appendix 1

<u>Implications</u>

Financial

1.1 None

Legal

2.1 None

Human Resources

3.1 None

Information Technology

4.1 None

Equalities Impact

5.1 None

Corporate objectives and priorities for change

6.1 None

Other (for example, Health and Safety, Environmental, Sustainability, Property and Asset Management, Risk Management and Safeguarding)

7.1 None